Section II.
Farm Marketing in a New Environment

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The $200 Billion Job of Marketing Our Food

By Alden C. Manchester

Wheat in an elevator in Kansas is of no use to the housewife in Atlanta who wants to make rolls for dinner. Cattle in a Texas feedlot are not steaks in New York. Potatoes in a field in Idaho are not french fries on the table at McDonald's in Los Angeles. The goods that farmers grow and sell must be stored, transported, processed, and delivered — and in the form consumers want, when they want them, and to the places where consumers are.

Farmers in an earlier day often sold directly to customers. Some still do. But specialization is the general rule today. Each function between the time the farmer first offers products for sale and the final purchase is performed by firms or persons who have a particular advantage or skill. Specialization — the division of labor — creates a series of activities in the market process. As the process becomes increasingly complex, as more and more steps come between the farmer and the buyer, agencies or individuals appear whose only business is to facilitate exchange of ownership: commodity exchanges, brokers, commission houses, auction companies.

Even though soil and climate in places in Louisiana and a few other States are most favorable for growing early strawberries, no farmer there could afford to produce on a commercial scale if the farmer had to carry the strawberries to Pittsburgh and peddle them from house to house. Adapting farm production to the various possibilities of soil and weather over our vast country depends chiefly on adequate transportation and on handling and sales agencies that do the job at reasonable cost.

Or if early strawberries are too narrow an example, consider any of the major commodities — oranges, which need the climate of the South; the great corn and livestock business built upon the rich soils and temperate climate of the Corn Belt; or the volume, methods, and location of wheat production in the Great Plains. Existence of such types of agriculture, organization of the farms within the areas, and year-to-year changes in farmers' decisions as to what to do rest on a highly geared marketing system made up of thousands of separate activities, each essentially independent but together one closely knit, flexible system.

Elevators, packing sheds, canneries, tobacco warehouses, cotton gins, local buyers, assemblers, auction markets; trucklines, railroads, and airfreight companies; commission houses, brokers, organized exchanges, credit institutions; packing plants, flour and textile mills, cigarette factories; wholesalers, jobbers,

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exporters, converters, factory sales representatives; supermarkets, convenience stores, fast food outlets, drugstores, restaurants — those are the kinds of activities that move farm products to consumers over the United States and the rest of the world.

Most of our food comes from U.S. farms; 89 percent of the value and 94 percent of the quantity. Since fish and imported foods bring higher prices per pound than the average of our farm foods, they account for 16 percent of the value of food consumed but only 7 percent of the quantity. Home food production, both farm and nonfarm, accounts for about 3 percent. A significant portion of the U.S. food supply goes abroad: 25 percent as much as is consumed at home. Less than 1 percent goes to nonfood uses. (These figures include only the food use of feedgrains such as corn and oats. Most of those grains are used as animal feed, including substantial quantities exported.)

About 72 percent of U.S. food is consumed at home, although away-from-home eating takes 38 percent of the food dollar since restaurant prices are considerably higher than grocery store prices to cover the cost of the additional services. Most food for use at home comes from the supermarket — 66 percent, up sharply from 37 percent in 1958. Convenience stores account for 4 percent and other grocery stores for 16 percent. Home delivery, mostly of milk

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and bread, is now less than 1 percent, compared to 5 percent in 1939. The away-from-home market has grown rapidly in recent years, primarily with the growth in sales of fast food establishments, which now account for 30 percent of eating-out dollars, compared to 6 percent in 1958. Sales at restaurants, lunchrooms and cafeterias are down from 56 percent of away-from-home sales in 1958 to 41 percent today.

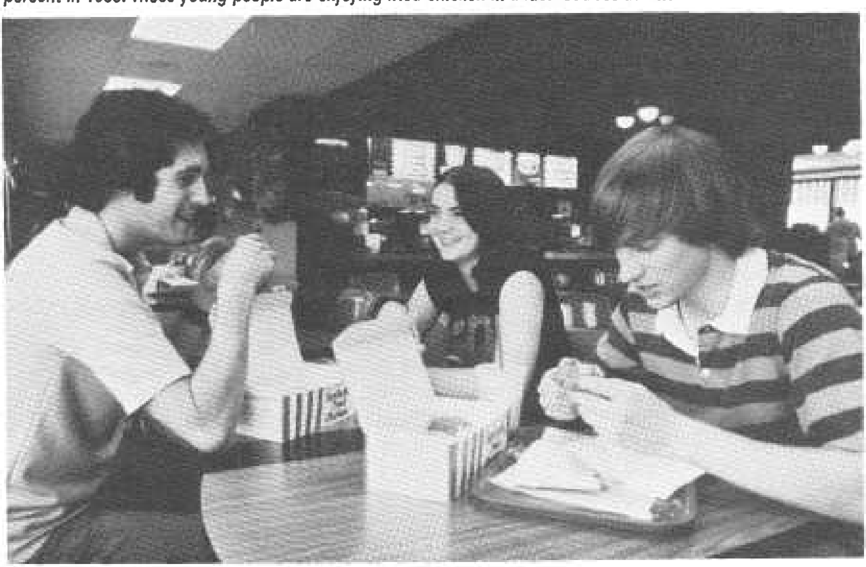
How It All Adds Up

U.S. farmers received $85 billion for the food which went to American consumers in 1981. The job of marketing that food cost $200 billion. The different functions break down like this: Processing, $76.2 billion; Transportation, $15.1 billion; Wholesaling, $23.4 billion; Retailing, $38.0 billion; Food service, $47.1 billion.

Looked at the other way, the costs of marketing cover: Labor, $87.9 billion. Packaging materials, $23.0 billion. Transportation, $15.1 billion. Energy, $10.3 billion. Corporate profits, $12.0 billion. Other, $51.2 billion.

The marketing system for agricultural products is much more like other parts of the economy than it was 30 years ago, but there still are major differences. Crop output cannot be closely controlled like, say, steel output because of the vagaries of weather. Many agricultural products are bulky, and production is widely dispersed and distant from consumers. There are long, fixed lags between the decision to produce and actual output, differing for annual crops such as wheat and corn, perennial crops such as apples and oranges, and livestock products like meat or milk. There are lags in industrial production too, but a somewhat higher degree of control. Most crops mature once a year — they cannot be produced continually. Many agricultural products

Fast food restaurants now account for 30 percent of eating-out dollars, compared to 6 percent in 1958. These young people are enjoying fried chicken in a fast food restaurant.



are highly perishable, such as milk and fresh fruit.

These differences mean the agricultural marketing system must deal with: Widely varying production from one year to another. The marketing system must accommodate these variations by storage or other means. Prices in any year are the result of these mismatches of supply and demand, so they send poor signals to farmers about future production plans. Prices may be way above costs or below them. Efforts to reduce risks through individual actions (contracting, forward selling, etc.), through group actions (bargaining and cooperative marketing), or through public efforts to change the system must also be dealt with in the marketing system.

Agricultural processing and distribution are characterized by large-scale corporate economic units. The 100 largest food and tobacco processing companies accounted for 52.5 percent of U.S. shipments of food and tobacco products in 1975. Another 100 companies accounted for an additional 11 percent. These 200 companies are broadly diversified. U.S. sales of processed foods, alcoholic beverages, and tobacco made up only 52 percent of their business.

Branding. Outputs of U.S. food manufacturers are either consumer food products or intermediate products used in their manufacture. Consumer food products are largely branded, many with strong brands that differentiate them from others. Manufacturers engage in a continual process of new product development and promotion as they seek to maintain or improve their own positions in the marketplace. A minority of brands belong to retailers or wholesalers, but the great majority are processor brands. Branding provides the basis for consumer identification of packaged food products and helps food manufacturers differentiate their products from those of other manufacturers. Constant attention to product development and differentiation provides a food manufacturer with a partially protected place in the market with somewhat higher returns.

Numbers of farmers and of marketing firms are declining as individual firms grow. In the broadest sense, changes in the structure of farming and of the marketing system are caused by the same set of forces. Technological change is one of the major forces creating pressures toward larger farms. It also has been a major contributor to the growth and size of food manufacturing and distribution plants and firms.

Changes in transportation technology have an obvious effect. Introduction of the motortruck made it possible for farmers to greatly expand the area where they might look for buyers of their products, at the same time increasing the area from which an assembler or manufacturer of agricultural products could economically purchase. This made larger, more efficient manufacturing plants possible and the numbers became fewer. Larger plants could exert more buying power but at the same time farmers could go farther to market, so the number of alternative outlets available to a typical farmer did not decline as fast as the total number of buyers.

Terminal Market Decline

Changes in farm product marketing to gain transport and handling economies led to new forms of trading. The rise in direct buying by processors and distributors brought about a decline in terminal markets, which once were great nerve centers for pricing and price information. Grain terminals, stockyards, wholesale poultry and egg markets, and fruit and vegetable markets brought together competitive forces over a wide area. Prices were openly established and news of price changes were spread widely by press and radio. These markets have been largely, but not entirely, replaced by direct dealing between the parties who used to meet in the markets.

Many of the organized markets of an earlier day have disappeared. Small farmers who brought their products for sale in these markets have either grown larger or gone into other lines of work. Small retailers who were the principal buyers in many of the markets have grown, gone into other lines of business, or found less time-consuming ways of buying products for their stores. Livestock auctions that once provided an outlet for the farmer with one or a few head of livestock to sell are much less important than they used to be, because there are many fewer farmers with a few head of livestock as a sideline. Livestock production is largely a specialized business, and specialized producers deal directly with the meat packer. Specialized buying firms which assemble small lots of livestock are much fewer in number than they once were.

As buying and selling arrangements changed, pricing systems have adapted. Terminal markets for livestock and wholesale markets for fresh fruits and vegetables are no longer the dominant pricemaking institutions they once were. The focus of pricemaking has moved

The motor truck has made it possible for the farmer to expand the area in which to look for buyers of his products. This 18-wheeler from North Carolina unloads at the Maryland wholesale produce market.

William E. Carnahan

back to the shipping point for fresh fruits and vegetables, but wholesalers still supply the majority of fresh produce. Pricemaking for livestock has been dispersed and now occurs mostly in private negotiations by telephone between producers and packers and between packers and large retailers.

The pricing system that has emerged for farm products has been shaped by inherent characteristics of farm products, needs and character of the modern processing and distribution sectors, and economics of the pricing systems themselves. The food and fiber marketing system includes big, highly rationalized businesses, often requiring a steady supply of particular farm products — vegetables, fruits, cotton, etc. Where there is little assurance of supply, such firms have actively generated a supply by entering into contracts with farmers or sometimes by direct ownership of production resources. A large firm may find it easier to coordinate economic activity via internal command rather than a price system, and decisions once made in the marketplace may shift to the firm as the nature of firms change.

As wages and salaries rose relative to the cost of capital, incentives grew to move away from time-consuming negotiation of prices for each transaction. Economies are gained, in many cases, by negotiating a general pricing formula and then placing specific orders by telephone. The formulas often rely on prices established on wholesale markets as base prices. Formula pricing is increasingly questioned, partly because of the thinness (small volume) of trading on wholesale markets, which suggests the possibility of

Livestock auctions are much less important today than they were many years ago, because there are fewer farmers with only a few head of livestock as a sideline. The Polled Hereford being auctioned here is at Senatobia, Miss.

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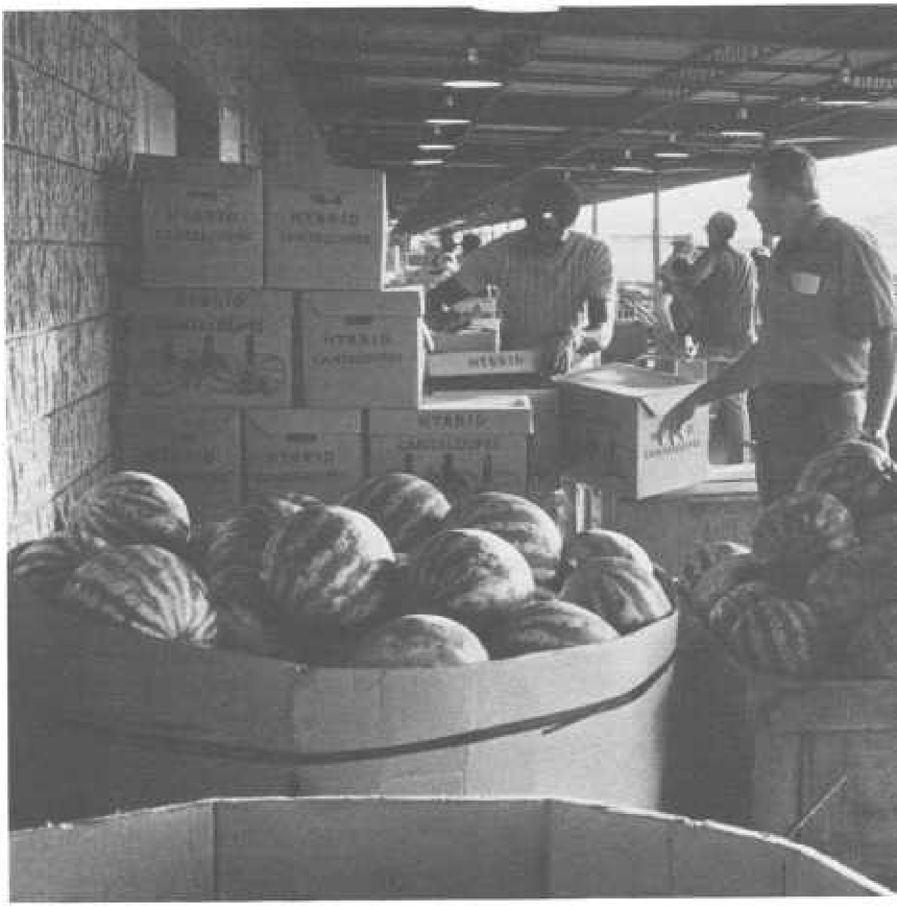
abuse, and partly because of the difficulty of reporting prices in a market that is so widely dispersed, perhaps offering differential advantages to some marketers.

Toward a Better Way

Hope for improving agricultural pricing systems lies in several directions. Physical presence of the commodity when buying and selling occur is unnecessary and can be wasteful. As long as the product can be described to the reasonable satisfaction of traders and delivery, payment and redress of grievances can be assured, satisfactory exchange can occur. Indeed, the commodity need not even be in existence when the transaction occurs. It is in this context that techniques for forward trading, futures trading, and electronic marketing can be understood and evaluated.

For some agricultural commodities, particularly those produced on a lot or batch basis for processing, little or no production is undertaken without a contract between producer and processor. Most of the broiler industry in the South was



built on this basis. Vegetables for processing are largely produced under contract.

Exceptions include perennials and crops which may be used either for processing or fresh market. Most asparagus, a perennial, is purchased on the open market for processing. The same varieties are used both for processing and fresh market. A number of varieties of potatoes are used both for processing and fresh market. Contracting accounts for a significant share of such production. Frequently the processor sorts potatoes received from the grower, sending top grades in selected size ranges to the fresh market and the remainder to processing.

Most other vegetables for processing are produced only under contract. In the majority of cases, contracting and production of such vegetables started together. In the early days, processors specified very tightly the product to be delivered and the terms and conditions. They often supplied seed and other inputs. As growers became accustomed to requirements of the buyers, contract terms became less detailed.

Marketing contracts, written or verbal, have been the usual way of selling continuously produced products such as milk and eggs for many years. Such contracts provide a method of setting prices and other terms of trade for commodities that move from farm to market every few days. Contracts where the contractor owns the hens have come into increased use for eggs in the last 20 years. Marketing contracts (forward selling) for staple commodities — grains, oilseeds, and cotton — came into use during the seventies. They are far from the dominant way of doing business for these commodities. They permit growers to shift some of their price risks and buyers to remove some uncertainties as to supply.

Another way of shifting the risk of price change is through futures trading. The number of agricultural products for which

David F. Warren

Wholesale markets for fresh fruits and vegetables are no longer the dominant price-making institutions they once were. However, wholesalers such as these in Maryland still supply the majority of fresh produce.

active futures trading exists has increased. It now includes spring wheat, hard winter wheat, soft red winter wheat, corn, soybeans, soybean oil and meal, oats, cotton, shell eggs, potatoes, fed steers, feeder cattle, slaughter hogs, iced broilers, sugar, and orange juice.

Salesmanship. To good salespeople, the American market is big, exciting, different. It is up to them to make the most of it, to catch the consumer's attention, to sell. Their efforts lead to advertising and the development of new services and products in an attempt to get a larger part of an established market and to enlarge the total market. Farm products and commodities processed from them — food, clothing, industrial materials of many kinds — get their share of this selling effort.

Ever since exchange gained a place in economic affairs, some form of selling effort has been a necessity. The producer and/or the vendor of a commodity or service was faced with the need to inform potential buyers of its availability and to persuade them to buy. Immediate interests of food processors, textile manufacturers, and others like them, and of those who wholesale and retail the products, are closely related. Advertising and sales activities of manufacturers and retailers are closely tied together.

The average American consumer expects the marketing system to keep goods flowing continuously into the handiest retail outlets, preferably at prices that allow a rising level of living. That goal requires just as much of the farmers as it does of the marketing system. American farm products also move into foreign markets. In them, too, despite an intervening web of trade difficulties that sometimes can considerably modify free-market demand, the basic marketing function is to find and serve the final user.

Facing this large and complex marketing system, what can a farmer do? What choices does the farmer have? Obviously, the farmer does not have as wide a range of options as, say, a manufacturer of household appliances. But the farmer does have a number of choices which will be discussed more fully in later chapters in this section.

While not having the same freedom in product design as the toaster manufacturer, farmers can affect characteristics of their products by choice of crop variety or livestock type and by decisions about some production practices. For example, the livestock feeder must decide how long and what to feed cattle and thus determine marketing weight and affect the grade. Acting as a group, farmers can have some influence on the demand for their products through advertising and other promotional efforts. Farmers must decide where to sell their products, a choice which affects the price received and the costs of selling.

Generally speaking, farmers are price takers — not price makers. But some choices are available: Sell at the current price (the spot market); Store and sell later; Deliver now but defer setting the price; Fix the price before delivery by a contract; "Lock in" a price on the futures market; Sell through a cooperative which pools all its members' sales and pays each the average price; Contract for a service payment not dependent on the market price, as in broilers. No one farmer has all these choices, but most have more than one.